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NSC FOR JSHRIER
COMMERCE FOR 4431/MAC/WH/JLAO

E.O. 12958: DECL: 01/30/2019
TAGS: ECON EFIN VE
SUBJECT: PARALLEL MARKET GROWING; PDVSA CONTINUING TO SUPPLY DOLLARS

REF: A. 2008 CARACAS 376
¶B. 2008 CARACAS 1758
¶C. 2008 CARACAS 1304
¶D. CARACAS 96

Classified By: Economic Counselor Darnall Steuart for reasons 1.4 (b) and (d).

¶1. (C) Financial executive Miguel Octavio (strictly protect throughout) told EconOffs January 28 that the amounts transacted on the parallel foreign exchange market have grown significantly in recent months. One year ago, Octavio's company averaged USD 3 million in transactions per business day; it now averages USD 7 million. He believes his company has maintained a market share of about 10 percent, which implies the market is now roughly USD 70 million per business day and has more than doubled over the course of 2008. Octavio said several companies that previously imported through CADIVI, the government of the Bolivarian Republic of Venezuela's (GBRV) foreign exchange control authority, had recently sought his company's help in obtaining dollars on the parallel market. These companies, which included importers of cell phones, cookies, and crackers, were unable to get either the necessary permits from the Ministry of Light Industries and Commerce or the final authorization for official dollars from CADIVI.

¶2. (C) Octavio confirmed PDVSA, the state oil company, was a leading supplier of dollars to the parallel market. PDVSA's sales of dollars were always made through one of several local brokers and always originated in the same Bank of America account. This group of brokers, which included one large broker and several smaller ones, coordinated the sales among themselves, presumably receiving good commissions. PDVSA's dollar sales were lower than the USD 150 million weekly it was apparently selling into the market for a period in October and November 2008. There did not seem to be any pattern to the daily amount sold - some days it could be substantial, other days nothing. One of the smaller brokers told Octavio PDVSA was making the transactions "legally," i.e. via a bond swap mechanism (handled by the brokers and permitted under BRV law) and with proper accounting. (Note: Octavio's estimate of the parallel market's size [USD 70 million per business day, or USD 350 million per week] is not necessarily inconsistent with PDVSA supplying less than USD 150 million per week to the market. PDVSA is clearly a leading supplier, but by no means the only one. Nonetheless, the parallel market is opaque, and no one's

numbers are perfect. Octavio's estimates are as well-informed as we are likely to get, but they are only estimates. End note.)

Background and Comment

¶3. (SBU) With CADIVI authorizations falling (ref A), it is no surprise more importers are shifting to the parallel market. As demand for dollars grows from importers and from Venezuelans and Venezuela-based companies seeking to reduce their bolivar exposure, the question is whether supply can keep up. By supplying the market with dollar-denominated bonds and other instruments (ref B), the GBRV was able to drive the parallel rate down from a high of 6.8 bolivars (Bs)/USD in November 2007 to a relatively stable level of 3.5 Bs/USD from mid-April to mid-August 2008. As the global financial crisis deepened, the financial instruments previously used by the GBRV to intervene in the parallel market became unavailable (ref C), and the rate has since climbed to 5.5 Bs/USD. While some private companies have brought in dollars via the parallel market (e.g., to provide working capital or, in once case, recapitalize a bank), the GBRV has apparently supplied the market since October via direct dollar sales by PDVSA.

¶4. (C) Like most local analysts we talk to, we believe the parallel rate has nowhere to go but up. Demand for dollars will continue to increase as CADIVI becomes more restrictive. Supply will likely grow more constrained as well. We find it hard to believe private companies will be willing to increase the dollars they are bringing into Venezuela, even if they are under pressure to self-finance operations because they are not being paid by PDVSA or other GBRV entities (septel). (Indeed, Octavio told us one company in this situation was exploring with his company the possibility of raising funds locally in bolivars rather than bring in dollars.) PDVSA can continue to supply some dollars to the parallel market, but at the cost of not paying suppliers (when the contracts are in dollars) or not replenishing Central Bank reserves. The National Development Fund

(Fonden), which recently received a USD 12 billion transfer from the Central Bank (ref D), may turn into the largest supplier of dollars to the parallel market in coming months. It has the means to keep the parallel rate from spiking in the short term, but over time its dollar assets, which will likely be used for certain priority imports and other payments in hard currency, will decline as well. End background and comment.
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